

## SEPARATING RESCISSION AND RESTITUTION

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*Abstract: This article argues that rescission of a contract and restitution of what passed under it are best viewed as two distinct operations. Similarly, inability to give counter-restitution, lapse of time, and third party rights, should not be bars to rescission; they are best accommodated at the restitution stage.*

Rescission is sometimes used to mean termination of a contract following repudiatory breach. That is not the topic addressed here. Rather, this article uses rescission in its meaning of setting aside a voidable contract tainted by misrepresentation, duress, undue influence or unconscionable conduct. The received view is that such rescission of a contract goes hand in hand with restitution of what passed under that contract. In other words, rescission and restitution are two sides of the same coin. The argument here is that rescission and restitution are best viewed as two separate events. Rescission is a matter for contract law (whether that remedy arises at common law or in equity). Restitution of what passed under the rescinded contract is primarily for the law of unjust enrichment, or a function of property law.

The received view is also that inability to give counter-restitution, lapse of time, and the interposition of third party rights in any property transferred, are bars to rescission. Properly characterised, these are concerned with restitution. It follows that, once rescission and restitution are separated, they should not be bars to rescission after all, but are better addressed at the restitution stage. So the inability to give counter-restitution will be relevant to a claim in unjust enrichment, where it is treated with greater nuance; the interposition of third party rights is adequately addressed through property law already; and lapse of time is

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redundant, its functions covered by affirmation in contract law, or the defence of change of position in unjust enrichment.

The reason for separating rescission and restitution is that separation produces law which is more coherent and fairer. What follows is predominantly an analysis from an English perspective; reference is also made to Australian law.

### **Conceptual Clarity**

We might begin by noting some examples of the current state of confusion over the relationship between rescission and restitution. One view is that rescission is conditional on mutual restitution.<sup>1</sup> It is said that the reason for this is to prevent unjust enrichment.<sup>2</sup> In which case, it would make sense to have the restitution aspect openly addressed by the law of unjust enrichment, not by blurring it with rescission in contract law. Another related view is that restitution happens automatically following rescission.<sup>3</sup> The point would seem to be that, if a party wants rescission, the restitution aspect is not optional. This aligns with the first view that rescission is conditional on mutual restitution. True, as we shall see, rescission can have automatic restitutionary consequences in property law, but in other cases, restitution need not follow automatically, or at all. A third view is that rescission is restitutionary because it

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<sup>1</sup> M Chen-Wishart, *Contract Law*, 5th edn, Oxford University Press, Oxford, 2015, p 235; M P Furmston, *Contract Law*, 16th edn, Oxford University Press, Oxford, 2012, p 361.

<sup>2</sup> Chen-Wishart, above, n 1, p 235; E McKendrick, *Contract Law*, 11th edn, Palgrave Macmillan, Basingstoke, 2015, p 236.

<sup>3</sup> G Virgo, *The Principles of the Law of Restitution*, 3rd edn, Oxford University Press, Oxford, 2015, p 22.

returns contractual rights to the promisor.<sup>4</sup> This seems conceptually awkward. It is not natural to talk about returning a promise to the promisor. And there is no need to engage in such intellectual contortions when a more straightforward explanation is available. Some case law stands against this approach.<sup>5</sup> A final view is that rescission is restitutionary only for executed contracts, but not for executory contracts.<sup>6</sup> But giving rescission a variety of different natures risks incoherence.

There is a more straightforward explanation. Rescission means setting aside the contract. Rescission does two things at the same time: it cancels future liabilities, and it cancels past liabilities. As Lionel Smith says, the very same circumstances which founded the contract also tainted it, creating both the contract rights and the power to cancel them.<sup>7</sup> It is entirely fitting that contract law decides when a contract is enforceable, and its corollary of when a contract is liable to be rescinded. But once a contract is set aside, then contract law is spent, because there is no longer any contract to work on. Subsequent restitution cannot be a matter of contract law. Instead, it is separately achieved elsewhere, for example through the law of unjust enrichment, or as a function of property law.

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<sup>4</sup> R Chambers, 'Two Types of Enrichment', in R Chambers et al, eds, *Philosophical Foundations of the Law of Unjust Enrichment*, Oxford University Press, Oxford, 2009, p 242; N Y Nahan, 'Rescission: A Case for Rejecting the Classical Model?' (1997) 27 *UW Aus LR* 66 at 72-73; Virgo, above, n 3, p 22.

<sup>5</sup> *Criterion Properties plc v Stratford UK Properties LLC* [2004] UKHL 28; [2004] 1 WLR 1846 at [27] (creation of contractual rights does not constitute receipt of any assets for the purposes of the wrong of knowing receipt); *National Commercial Bank (Jamaica) Ltd v Hew* [2003] UKPC 51; [2003] All ER (D) 402 (Jun) at [43] (with a guarantee, the surety incurs a liability but obtains no benefit, so there is nothing to disgorge by way of counter-restitution if the guarantee is set aside).

<sup>6</sup> See the discussion at A Burrows, *The Law of Restitution*, 3rd edn, Oxford University Press, Oxford, 2011, pp 17-20.

<sup>7</sup> Lionel Smith, 'Unjust Enrichment: Big or Small?', open access version at pp 13-14, also published in S Degeling and J Edelman, eds, *Unjust Enrichment in Commercial Law*, Law Book Co, Sydney, 2008.

Not only is this a simpler explanation of rescission, and its relationship with restitution, but also it more clearly demarks the province of unjust enrichment, as follows.

The unjust factors which underpin any cause of action in unjust enrichment map well onto contract law. The unjust factors include mistake (which itself includes the induced mistake of misrepresentation), duress, undue influence and unconscionable conduct. It is no surprise that the vitiating factors in contract law find corresponding unjust factors in the law of unjust enrichment, for two reasons. First, when the law of obligations was still constrained by the forms of action, unjust enrichment could only begin to evolve using similar approaches and terminology to contract law. Hence in its early development it appeared as implied contract theory or quasi-contract. Second, unjust enrichment still fills a need in its relationship with contract law, providing a solution to the post-contract problem of recovering money after a contract has been rescinded.

Note, however, that the shared history and current symbiosis does not mean that unjust enrichment is merely an extension of contract law. Implied contract theory has been denounced as a fiction – the law should not proceed upon fictions – and unjust enrichment recognised as an autonomous cause of action.<sup>8</sup> Unjust enrichment also reaches out further than contract law. For example, the unjust factor ‘total failure of consideration’ applies not just to unfulfilled promises, but also to unfulfilled legitimate expectations which fall short of contract.<sup>9</sup> What is more, money can be recovered in unjust enrichment when it was paid

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<sup>8</sup> *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221; *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 710.

<sup>9</sup> *Degelman v Guaranty Trust Co of Canada* [1954] 3 DLR 785; *Yeoman's Row Management Ltd v Cobbe* [2008] UKHL 55; [2008] 4 All ER 713; *William Lacey (Hounslow) Ltd v Davis* [1957] 2 All ER 712; *British Steel Corp v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504.

under legal compulsion,<sup>10</sup> or pursuant to an illegal activity from which the claimant has withdrawn,<sup>11</sup> or in consequence of a public authority acting ultra vires.<sup>12</sup> Unjust enrichment can also apply when the transaction was one of gift.<sup>13</sup>

Separating rescission and restitution thus acknowledges the independence of unjust enrichment as a cause of action, with its own sphere of operation. Whereas bundling rescission and restitution together reverts to the discredited historical position which saw unjust enrichment as merely an extension of contract law, as quasi-contract.

Separation also simplifies two further areas of controversy.

The first controversy is this. Bant subscribes to the received view that rescission automatically effects restitution.<sup>14</sup> She then points out as anomalous that, while restitution following a claim in unjust enrichment depends on a court order, restitution following rescission happens without a court order simply as a consequence of the claimant electing to rescind, which is a self-help remedy.<sup>15</sup> For O'Sullivan, it is not merely anomalous, but

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<sup>10</sup> *Exall v Partridge* (1799) 8 Term Rep 308; 101 ER 1405; *Gebhardt v Saunders* [1892] 2 QB 452; *Brook's Wharf and Bull Wharf Ltd v Goodman Bros* [1937] 1 KB 534; *Greene Wood McLean LLP v Templeton Insurance Ltd* [2010] EWHC 2679 (Comm); [2011] Lloyd's Rep IR 557.

<sup>11</sup> *Tribe v Tribe* [1996] Ch 107.

<sup>12</sup> *Woolwich Equitable Building Society v IRC* [1993] AC 70; *Auckland Harbour Board v R* [1924] AC 318.

<sup>13</sup> *Allcard v Skinner* (1887) 36 Ch D 145; *Re Glubb* [1900] 1 Ch 354; *Clarke v Prus* [1995] NPC 41.

<sup>14</sup> E Bant, 'Reconsidering the Role of Election in Rescission' (2012) 32 *OJLS* 467.

<sup>15</sup> At least, rescission at common law is a self-help remedy: *Car and Universal Finance Co Ltd v Caldwell* [1965] 1 QB 525; *Brotherton v Aseguradora Cobeguros (No 2)* [2003] EWCA Civ 705; [2003] 3 All ER (Comm) 298 at [27]. Query whether the equitable remedy of rescission is at the discretion of the court: *Spence v Crawford* [1939] 3 All ER 271 at 288 (yes discretion), endorsed in *Cheese v Thomas* [1994] 1 WLR 129 at 137; *Alati v Kruger* (1955) 94 CLR 216 at 224 (no discretion); *TSB Bank plc v Camfield* [1995] 1 WLR 430 at 438 (no discretion). But once again, if rescission has no restitutionary consequence, because rescission and

productive of ‘considerable difficulty’. How can a claimant elect rescission-and-restitution, and thereby avoid judicial scrutiny of the bars to rescission?<sup>16</sup> But if rescission and restitution are separated, these problems disappear. Rescission can remain a matter of election, in contract law.<sup>17</sup> Restitution must be sought separately, by making out a cause of action in unjust enrichment, where the so-called bars to rescission can still be raised, albeit in their proper character.

The second controversy is whether a contract might only be rescinded in part. English law says no,<sup>18</sup> and not without reason. First, to repeat, the orthodox position is that rescission is a self-help remedy requiring no approval from the court. That disappears if the court can insist upon partial rescission instead.<sup>19</sup> Second, affirmation is a bar to rescission, but affirmation itself is all or nothing. A claimant cannot choose to rescind parts of a contract but affirm other parts. So too it is doubtful that the courts can do this at one party’s request.<sup>20</sup>

But in Australia the decision in *Vadasz v Pioneer Concrete (SA) Pty Ltd* says yes to partial rescission.<sup>21</sup> That was a case of fraudulent misrepresentation. The claimant signed a guarantee of a debtor’s past and future liability, when he was told by the creditor that the guarantee only extended to future liability. The court granted rescission as to past liability,

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restitution are separated, there may never be reason to refuse any rescission the entitlement to which is otherwise made out.

<sup>16</sup> J O’Sullivan, ‘Rescission as a Self-Help Remedy: A Critical Analysis’ (2000) 59 *CLJ* 509.

<sup>17</sup> Disputes might still arise as to whether the claimant was entitled to rescind. But if they were entitled, that is the end of the matter.

<sup>18</sup> *TSB Bank plc v Camfield* [1995] 1 WLR 430; *Kennedy v Kennedy* [2014] EWHC 4129 (Ch); [2014] All ER (D) 79 (Dec) at [46].

<sup>19</sup> D O’Sullivan, ‘Partial Rescission for misrepresentation in Australia’ (1997) 113 *LQR* 16 at 17.

<sup>20</sup> E Peel (ed), *Treitel, The Law of Contract*, 13th edn, Sweet & Maxwell, London, 2011, at [9-110].

<sup>21</sup> (1995) 184 CLR 102; 130 ALR 570.

but held the claimant to a guarantee of future liability (ie liability arising after the guarantee was given). The court said that the reason for insisting upon partial rescission was ‘to prevent one party obtaining an unwarranted benefit at the expense of the other’,<sup>22</sup> language which looks very much like unjust enrichment, as commentators have explicitly acknowledged.<sup>23</sup> But unjust enrichment, the cause of action, rather than just a descriptive label or synonym for ‘fairness’, ordinarily provides only for money remedies. In no other case founded upon unjust enrichment as a cause of action has the remedy been the imposition of a contract. Such a general remedy would be extraordinary. If the fair outcome of *Vadasz* was indeed to hold the claimant to the *already existing* guarantee, but only to the extent he thought he was giving, it may have been more appropriate to invoke contract law techniques like rectification or estoppel by convention.<sup>24</sup>

In other words, cases like *Vadasz* become clearer when rescission and restitution are separated. Rescission is about setting aside a contract. Partial rescission is more accurately characterised as asking what of an existing contract should remain, despite a vitiating factor. Both are really a matter for contract law.<sup>25</sup> Restitution is about whether any thing or money has to be handed back thereafter. And indeed, the very fact that a partial contract remains might preclude restitution at all, for example because there has not been a *total* failure of performance, or because there is a defence of entitlement (on which, see below).

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<sup>22</sup> (1995) 184 CLR 102 at 114.

<sup>23</sup> L Proksch, ‘Rescission on Terms’ (1996) 4 *RLR* 71 at 75.

<sup>24</sup> Proksch, above, n 23; O’Sullivan, above, n 19; J Poole and A Keyser, ‘Justifying Partial Rescission in English Law’ (2005) 121 *LQR* 273.

<sup>25</sup> See too Virgo, above, n 3, p 22, who says that ‘rescission does not necessarily have restitutionary consequences’, and then gives the example of partial rescission. The clear implication is his view that partial rescission has nothing to do with restitution.

Finally in this section, separating rescission and restitution also tidies up contract law by making the vitiating factors of contract law more cohesive. It does this by aligning those factors which render a contract voidable (misrepresentation, duress, undue influence and unconscionable conduct) with both mistake and frustration.

As for mistake, it renders a contract void, as if the contract never existed. If anything passed under the void contract, then it cannot be recovered in contract law. Contract law declares the contract void for mistake, but can then do no more because, once again, there is no contract to work on. Title to property will have remained with the transferor.<sup>26</sup> Or a claimant can seek a money remedy in unjust enrichment, relying on the unjust factor of mistake to do so.<sup>27</sup>

As for frustration, that terminates a contract. Future liabilities are extinguished, but past liabilities remain in place. Contract law can effect no financial adjustment between the parties. The recipient of money paid under past liabilities remains contractually entitled to them, even if, with the early termination of the contract, that results in the payor being unfairly out of pocket. Similarly, no more money is payable, even if that means the payee has worked without fair compensation, because future liabilities are extinguished. Contract law cannot assist: with future liabilities extinguished, it has nothing to work with, and past liabilities have been frozen in place. The old position was therefore: losses lie where they fall.<sup>28</sup> There were two solutions. One was a claim in unjust enrichment on the basis, where available, of 'total failure of consideration'.<sup>29</sup> The other is statutory, giving the courts discretion to make a financial adjustment between the parties to ensure a just allocation of

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<sup>26</sup> *Cundy v Lindsay* (1878) 3 App Cas 459 at 466.

<sup>27</sup> *Rover International Ltd v Cannon Film Sales Ltd (No 3)* [1989] 3 All ER 423.

<sup>28</sup> *Chandler v Webster* [1904] 1 KB 493; *Appleby v Myers* (1867) LR 2 CP 651.

<sup>29</sup> *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32.



losses.<sup>30</sup> Even then, the principles underlying that statute have been described as founded, at least primarily, upon unjust enrichment.<sup>31</sup> In other words, contract law says when a contract is frustrated and so terminated, at which point contract law is exhausted, and it is then the principles of unjust enrichment, albeit now enshrined in statute, which subsequently effect any recovery of money.

Thus with mistake and frustration, it is already the case that contract law determines the status of the contract, void and terminated respectively, with any restitution thereafter the province of unjust enrichment or property law. When rescission and restitution are kept separate, it is the same arrangement for the other vitiating factors (misrepresentation, duress, undue influence, and unconscionable conduct), thus rendering this area of contract law more neatly aligned.

### **Removing Bars to Rescission**

It is also fairer to separate rescission and restitution, and in doing so to remove the bars to rescission: inability to give counter-restitution, lapse of time, and the interposition of third party rights in property. We shall take each bar to rescission in turn.

#### **Inability to Give Counter-Restitution**

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<sup>30</sup> Law Reform (Frustrated Contracts) Act 1943 (UK). Frustrated contracts legislation also exists in New South Wales, South Australia, and Victoria.

<sup>31</sup> *BP Exploration Co (Libya) Ltd v Hunt (No 2)* [1979] 1 WLR 783, on appeal at [1981] 1 WLR 232; Chen-Wishart, above, n 1; Virgo, above, n 3, p 357; the 1943 Act is ‘the most important statute in the law of unjust enrichment’ according to Burrows, above, n 6, p 361.

The need to give counter-restitution is usually considered a bar to rescission in contract law. Here is how that can produce an unfair result. Assume a voidable contract which has been partially performed. The claimant has received something under the contract, and perhaps even paid for it, but more is still to come, and to be paid for. However, now the claimant wants to rescind the contract, and recover their payment.

If rescission and restitution are bundled together in contract law, then when the claimant seeks to rescind, their entitlement to restitution is considered at the same time, and so too therefore the need to give counter-restitution. If the claimant cannot give counter-restitution, then rescission is barred. The claimant is tied into the remainder of a contract admittedly procured by the defendant's misconduct (let's say duress, for example).<sup>32</sup> Put another way, the claimant's inability to give counter-restitution means that the tainted contract is specifically enforced against them. The claimant is triply damned, obtaining neither rescission nor restitution, but instead obliged to continue honouring, and paying out under, the remainder of an admittedly tainted contract.

There are a number of ways in which a claimant might be unable to give counter-restitution of what has been received under the voidable contract. Traditionally, following rescission at common law, the claimant was obliged to return the thing itself in its original condition,<sup>33</sup> and not a substitute.<sup>34</sup> Equity was always more flexible. A claimant might be able to return the thing itself in a worse state, but with a compensating payment.<sup>35</sup> Or return, not

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<sup>32</sup> See too: M Chen-Wishart, 'Unjust Factors and the Restitutionary Response' (2000) 20 *OJLS* 557 at 567.

<sup>33</sup> *Clarke v Dickson* (1858) EB & E 148; 27 LJQB 223; 120 ER 463.

<sup>34</sup> *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1994] 4 All ER 225 at 234.

The original shares had been sold, and it was not good enough simply to buy replacements. But that proposition was queried on appeal: [1997] AC 254, 262.

<sup>35</sup> *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218; *Alati v Kruger* (1955) 94 CLR 216.

the thing itself, but a money equivalent.<sup>36</sup> There are calls for equity's approach to apply across the board.<sup>37</sup> Then again, it would not need to, if rescission and restitution were separated.

At any rate, there is an objection to equity's approach, and further problems it does not solve. Let's take the objection first.

Equity's flexibility is couched in terms of doing 'practical justice'.<sup>38</sup> No doubt all law aspires to produce just results. But the law usually seeks justice through the application of principles. In contrast, simple reference 'practical justice', on its own, is unprincipled. It depends entirely on the whim of the court. Even aside from theoretical objections that that looks more like the naked exercise of power than the rule of law, it risks making the law inconsistent and unpredictable. If the law is unpredictable, then it cannot guide behaviour, and its major function is deprived of value. Yes, in other areas, the court has discretion whether to grant an equitable remedy, like an interim injunction, but the exercise of discretion is still usually guided by well-established principles.<sup>39</sup>

What is the 'practical justice' in requiring a claimant to give counter-restitution at all? Surely the answer is: because otherwise the claimant would end up unjustly enriched. Virgo seems to say as much,<sup>40</sup> and it appears to be the implicit assumption with a number of other commentators, who accept that the need for counter-restitution is to prevent the rescinding

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<sup>36</sup> *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428; *Mahoney v Purnell* [1996] 3 All ER 61.

<sup>37</sup> Chen-Wishart, above, n 1, pp 239-240; Burrows, above, n 6, pp 250-251; Virgo, above, n 3, p 29.

<sup>38</sup> This notion originates in *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218 at 1279. It retains currency: *Alati v Kruger* (1955) 94 CLR 216 at 223; *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 184 CLR 102; 130 ALR 570; *Halpern v Halpern* [2007] EWCA Civ 291; [2007] All ER (D) 38 (Apr) at [60], [75].

<sup>39</sup> In the case of interim injunctions, those principles are set out in: *American Cyanamid Co v Ethicon Ltd* [1975] AC 396.

<sup>40</sup> Virgo, above, n 3, p 24.

party ending up unjustly enriched, whether the rescission happens at common law or in equity.<sup>41</sup> Happily, unjust enrichment is a well-developed cause of action founded on principle and illustrated by binding precedent. It is a more sure-footed and predictable way of arriving at a just outcome than relying on the vague equitable notion of ‘practical justice’.

Now for the problems which equity’s flexible approach still cannot solve. Two in particular stand out.

The first is where the counter-restitution in effect repeats the contract which has just been set aside. For example, the claimant receives services, and pays for them at the market rate, under a contract voidable for duress. If rescission and restitution are bundled together, then when the claimant sets aside the contract, they are entitled to recover the payment, but then they must also make counter-restitution. Services are intangible, and so cannot be returned – so too goods which perish or are consumed. Equity would allow payment of a money equivalent. But that would usually meaning paying the market rate for them, which is precisely the arrangement the claimant is trying to undo. And so the case law recognises an ad hoc exception to the requirement to give counter-restitution in such circumstances.<sup>42</sup> The need for an ad hoc exception is telling. It suggests a weakness in the underlying theory.

The second problem is where the claimant simply cannot afford to give counter-restitution, because they do not have the money. This situation might arise, for example,

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<sup>41</sup> McKendrick, above, n 2, pp 236-237; M Chen-Wishart, above, n 1, pp 239-240; J Beatson et al, *Anson’s Law of Contract*, 29th edn, Oxford University Press, Oxford, 2010, pp 316-317.

<sup>42</sup> *Halpern v Halpern* [2007] EWCA Civ 291; [2007] All ER (D) 38 (Apr) at [73]. See too *Borelli v Ting* [2010] UKPC 21; [2010] Bus LR 1718: there is no need to restore a defendant to their original position when that original position was the very compulsion or exploitation which entitles the claimant to rescind.

where the claimant has entered into a contract under duress, when they could not afford it in the first place.<sup>43</sup>

None of this is a problem if rescission and restitution are separated. Let us return to our example of a voidable contract which is partially performed. To begin with, a claimant might be able to rescind the contract simply on account of the vitiating factor (say, duress). This means the contract is set aside, with both past and future liabilities wiped away. The claimant is no longer tied into the remainder of the contract. That seems a fair result in itself. It is now a separate and subsequent question whether the claimant can recover the money they have already paid over.

To recover such money, the claimant might advance a claim in unjust enrichment, based upon the unjust factor of duress. But the defendant could counterclaim, perhaps alleging that they are entitled to retain the money after all, otherwise the claimant would end up unjustly enriched themselves. This possibility is often recognised as a defence in unjust enrichment, that a defendant need not make restitution if the claimant does not give counter-restitution.<sup>44</sup> Either way, it means the need to give counter-restitution is still raised. Furthermore, in unjust enrichment, restitution and counter-restitution is never of the thing itself, it is always a money payment.<sup>45</sup> In other words, a more flexible response is already built in. Now, if despite that, the claimant still cannot give counter-restitution, then maybe they cannot obtain restitution either. But that stalemate only relates to the claim in unjust

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<sup>43</sup> By analogy, it is often good evidence of undue influence that a claimant has entered into a transaction which leaves them unable to provide for themselves in the future, or only precariously: *Allcard v Skinner* (1887) 36 Ch D 145; *Cheese v Thomas* [1994] 1 WLR 129; *Hammond v Osborn* [2002] EWCA Civ 885; [2002] All ER (D) 232 (Jun); *Hart v Burbidge* [2014] EWCA Civ 992; [2014] All ER (D) 235 (Jul).

<sup>44</sup> Burrows, above, n 6, p 569.

<sup>45</sup> L Pearce, 'Rescission, *Restitutio in Integrum* and Termination Agreements' (2008) 16 *RLR* 124 at 126.

enrichment. At least the contract has been successfully rescinded, with the claimant freed from having to pay even more money under a contract admittedly procured by duress.

But the story does not end there, because unjust enrichment has a number of mechanisms which enable it to achieve a more nuanced result. Perhaps the most important here is the notion of ‘subjective devaluation’. This is not simply about a party asserting that the receipt is worth less to them than its market value. More fundamentally, the doctrine is about protecting the party’s autonomy, preventing obligations being imposed upon them behind their back or against their will.<sup>46</sup> It enables a party to say that they acknowledge the market value of the receipt, but would never have chosen it anyway. This addresses head on the situation where a party cannot afford a contract and would not have entered into it but for the other’s misconduct. It avoids any need for the ad hoc exception to counter-restitution mentioned above, because it removes the need for counter-restitution in the first place.

In summary, if inability to give counter-restitution is a bar to rescission, it can tie a claimant unfairly into the remainder of an admittedly tainted contract. If rescission and restitution are separated, at least the claimant can escape the unfair contract. And when the claimant subsequently seeks restitution, in unjust enrichment, the issue of counter-restitution is considered then, where it receives more nuanced treatment thanks to the notion of subjective devaluation.

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<sup>46</sup> *Falcke v Scottish Imperial Insurance Co* (1886) 34 Ch D 234; *Benedetti v Sawiris* [2013] UKSC 50; [2014] AC 938.

## Lapse of Time

In this section, we shall consider lapse of time, the bar ‘for which it is most difficult to find convincing justifications’.<sup>47</sup> There are two cases in particular which we must discuss. The first is the founding precedent of *Lindsay Petroleum Co v Hurd*,<sup>48</sup> where it was said that lapse of time should bar a remedy.<sup>49</sup>

[w]here it would be practically unjust to give a remedy, either [1] because the party has ... done that which might fairly be regarded as equivalent to a waiver of it, or [2] where ... he has ... put the other party in a situation in which it would not be reasonable to place him if the remedy were afterwards asserted ...

As for [1], that is already covered elsewhere in contract law by affirmation. Now affirmation *does* preclude rescission, and rightly so. Contracts are valuable because they are reliable. If a contract is tainted, and so voidable, its status should be resolved if any value is to be salvaged. The promisor should not be able to blow hot and cold, and once he has decided to affirm the contract, he cannot go back and rescind it. Now, the courts have recognised that delay itself can impute affirmation.<sup>50</sup> So too have commentators.<sup>51</sup> All the more so if, during that period of delay, the claimant continues to act as if the contract is on foot.<sup>52</sup>

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<sup>47</sup> R Stone, *The Modern Law of Contract*, 10th edn, Routledge, Abingdon, 2013, p 288.

<sup>48</sup> (1874) LR 5 PC 221.

<sup>49</sup> (1874) LR 5 PC 221 at 239-240 (numbers added).

<sup>50</sup> *Clough v London & NW Rly Co* (1871) LR 7 Exch 26; *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* [1979] QB 705. See too cases where the claimant abides by their gift and thereby affirms it: *Allcard v Skinner* (1887) 36 Ch D 145; *Mitchell v Homfray* (1881) 8 QBD 587.

As for [2], it postulates that, after a lapse of time, it might be unreasonable or unfair to require a party to make restitution. This is more skilfully addressed in unjust enrichment through the defence of change of position. That defence acknowledges that it may be inequitable to require a party to make restitution if they have changed their position, in good faith, in reliance upon their receipt.<sup>53</sup> Lapse of time might provide an explanation for how a party has come to change their position in good faith, but as a separate doctrine lapse of time seems redundant. Why should lapse of time on its own enable a party to escape liability, if they have not affirmed the contract, or not otherwise changed their position?

The second case we need to consider, which looms large in favour of lapse of time as a bar to rescission, is *Leaf v International Galleries*,<sup>54</sup> but its reasoning on this issue is flawed.<sup>55</sup> In that case, a buyer bought a painting of Salisbury Cathedral which the seller innocently misrepresented was by Constable. The buyer only discovered that the painting was not by Constable five years later when he took the painting to auction. The buyer sought rescission of the sale contract and restitution of the purchase price. There were no practical impediments to prevent restitution, yet he was denied any remedy.

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<sup>51</sup> Mitchel et al, *Goff and Jones, The Law of Unjust Enrichment*, 8th edn, Sweet & Maxwell, London, 2011, at [40-12]; Virgo, above, n 3, p 28; Peel, above, n 20, at [10-032]; A Hudson, *Equity & Trusts*, 7<sup>th</sup> edn, Routledge, London, 2013, p 1237.

<sup>52</sup> *Scholey v Central Rly Co of Venezuela* (1867) LR 9 Eq 266 (continuing to take dividends from shares); *United Shoe Machinery Co v Brunet* [1909] AC 330 (continuing to use goods); *Kennard v Ashman* (1894) 10 TLR 213, affirmed (1894) 10 TLR 447 (continuing to reside at premises).

<sup>53</sup> *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548.

<sup>54</sup> [1950] 2 KB 86.

<sup>55</sup> For the historical context of this case, and the distortion of its importance, see: A Fernandez, 'An Object Lesson in Speculation: Multiple Views of the Cathedral in *Leaf v International Galleries*' (2008) 58 *University of Toronto LJ* 481.



Denning LJ said that the identity of the painter was a condition of the contract. (The buyer could have sued for breach of contract, but did not do so.) Denning LJ said that the right to reject non-conforming goods was lost upon their acceptance. Acceptance was deemed when receipt of the goods was followed by ‘the lapse of a reasonable period of time’, according to section 35 of the (then) Sale of Goods Act 1893 (UK). He said that the passage of five years was a lapse of a reasonable period of time. Thus the goods could not now be rejected.

But Denning LJ went on to say that an innocent misrepresentation is less serious than a breach of contractual condition, so that, a fortiori, the right to rescind for innocent misrepresentation must also be barred by a lapse of time. There are two objections to this.

First, why was the misrepresentation less serious? It is difficult to discern any sensible difference in gravity between a promise broken by honest mistake, and an honest but mistaken representation which you know the other party is relying upon. A promise can lead to certain types of remedy, a misrepresentation to other types, but it is not as though, for example, damages in tort are less serious than damages in contract. And given that innocent misrepresentation can lead to rescission of a contract – a setting aside of all promises – does that not show the seriousness with which it is viewed?

Second, the right to reject non-conforming goods is conceptually distinct from the right to rescind a contract for misrepresentation. The two are not coextensive, as Denning LJ would have it. It makes sense to say that, after a period of time, the recipient who retains the goods is deemed to have accepted them. But why should a misrepresentation become spent merely by the passage of time – especially if the reason for inaction is because the representee continues under its sway? (If the representee is now disabused, but still does not rescind, then the contract is affirmed.)

Jenkins LJ said that contracts cannot be open and subject to the possibility of rescission indefinitely.<sup>56</sup> Again, why not, if what keeps them open is the continuing effect of the defendant's own behaviour? Otherwise we end up in the unattractive position that the more enduring or pervasive the defendant's influence, the more likely the defendant will get away with it. Indeed, in other cases, the court has said that mere lapse of time on its own is *not* enough to bar rescission, and rescission has been allowed despite lapses of time up to fifteen years.<sup>57</sup>

Evershed MR was worried that the longer the contract remained open to rescission, the harder it would be to unravel the transaction.<sup>58</sup> But the law of unjust enrichment is well equipped to deal with any such difficulties, through the defence of change of position, and consideration of any need to make counter-restitution. True, the longer a contract is open, the more likely that third party rights have interposed, but that issue, considered below, is again something separate from a mere lapse of time.

(Note also that the courts now have discretion under section 2(2) of the Misrepresentation Act 1967 (UK) to award damages in lieu of rescission, in cases of non-fraudulent misrepresentation, if it would be equitable to do so. This might be the case where a misrepresentation can be cured cheaply, in contrast to the serious financial consequences of rescission.<sup>59</sup> Nevertheless, the point is this: even where rescission is barred under s 2(2), and the claimant is tied to the contract, still they get a remedy of damages in lieu. In contrast, the common law bars to rescission would purport to preclude both rescission and restitution, leaving a claimant tied to an unfair contract without any money remedy.)

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<sup>56</sup> [1950] 2 KB 86 at 92.

<sup>57</sup> *Armstrong v Jackson* [1917] 2 KB 822 at 830.

<sup>58</sup> [1950] 2 KB 86 at 94.

<sup>59</sup> *William Sindall plc v Cambridgeshire County Council* [1994] 3 All ER 932.

Let us therefore accept that the reasoning in neither *Lindsay Petroleum* nor *Leaf* is sufficient to preclude us questioning the sense of lapse of time as a bar to rescission.

We return to our earlier example of a partially performed, voidable contract procured, for example, by duress. If rescission and restitution are bundled together in contract law, and lapse of time is applied as a bar to rescission, there might be unfair results. Thus if the claimant seeks rescission, but time has lapsed, rescission might be denied, tying them to the remainder of a contract admittedly procured by duress, without any further remedy. This might be so even though the lapse of time does not amount to affirmation, or even if the reason for delay is because the claimant remained under duress. It would make no difference that the defendant could give restitution, nor, if they could not give restitution, that this was only because they had acted in bad faith. All this seems grossly unfair.

In contrast, if rescission and restitution are separated, first, the contract might be rescinded for duress, so long as the delay does not amount to affirmation. (Both the availability of rescission, and the doctrine of affirmation, are located within contract law, so still it is naturally a matter for contract law whether the contract is enforceable or voidable.) At this point, the claimant is at least freed from the remainder of the unfair contract.

Then the claimant might seek to recover any money paid under the rescinded contract in unjust enrichment. At which point, the defendant might raise a defence of change of position, or argue that counter-restitution must be given – which in turn might engage the doctrine of subject devaluation. All of which shows the potential complexity of the circumstances, which are addressed in a targeted and clever way in the law of unjust enrichment, as opposed to brushed over clumsily by lapse of time as an ill-fitting bar to rescission in contract law.

### Third Party Rights

The term ‘proprietary restitution’ is in popular use. It can be misleading, because it refers to a remedy or consequence without identifying the cause of action or legal basis which produced it. For example, it is an on-going controversy whether unjust enrichment can yield proprietary remedies. It is the ‘last unsolved mystery’ according to Burrows.<sup>60</sup> I have written elsewhere why I do not think that unjust enrichment should yield proprietary remedies.<sup>61</sup> But we do not need to resolve that controversy here. Whether or not unjust enrichment can result in proprietary remedies, that is a matter for the law of unjust enrichment, and need have no impact on the argument that rescission be a separate matter for contract law.

Rescission can have proprietary consequences. Where a contract is void for mistake, any purported transfer of property thereunder is a nullity from the outset, and title remains at all times with the transferor.<sup>62</sup> If the transferor wants to recapture his property, he does so by relying on his title. So too if he sues for conversion. The approach is similar where a contract is rescinded: title to property which previously passed under the now-rescinded contract can re-vest in the transferor, as if it were there all along.<sup>63</sup>

In other words, rescission takes place in contract law, but the proprietary consequences do not. Indeed they cannot because, following rescission, there is no contract. Rather, the setting aside of the contract reveals and restores an underlying previous state of affairs in property. The two are separate.

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<sup>60</sup> A Burrows, ‘Unravelling Proprietary Restitution: A Response to Professor Lionel Smith’ (2005) 41 *Canadian Business Law Journal* 424.

<sup>61</sup> *The Law of Unjust Enrichment* (forthcoming 2016), at ch 18.

<sup>62</sup> *Cundy v Lindsay* (1878) 3 App Cas 459 at 466.

<sup>63</sup> *Car and Universal Finance Co Ltd v Caldwell* [1965] 1 QB 525. Or perhaps a claimant can, through rescission, re-vest equitable title and thereby set up a resulting trust: *El Ajou v Dollar Land Holdings plc* [1993] 3 All ER 717 at 734, reversed on a different point at [1994] 2 All ER 685.

For completeness, I note that Swadling disputes the orthodox view that title re-vests following rescission.<sup>64</sup> He accepts that, if a contract transfers title, then rescinding the contract can lead to a re-vesting of title. But he says that title can be transferred, despite a contract, by subsequent delivery. But as Häcker points out, where title transfers once by contract, it cannot transfer a second time by subsequent delivery, so rescission of the contract will also undo the first and only transfer of title.<sup>65</sup> In other words, rescission will lead to a re-vesting of title.

Traditionally, a bar to rescission arises when third party rights are interposed. For example, A might transfer property to B under a voidable contract. At that point, B obtains a good title which they can pass on. B might then transfer the property to C, a good faith purchaser for value without notice. Only afterwards does A seek to rescind the A-B contract. Title cannot now re-vest in A, because it rests legitimately with C. This fact, it is said, bars rescission.<sup>66</sup> But why? True, A cannot recover title to the property *from C*, but why should that stop A from rescinding the contract *with B*? Häcker argues that A should be able to rescind,<sup>67</sup> to clear the path for a personal remedy against B, or even a proprietary remedy by tracing to the proceeds of sale.<sup>68</sup>

We can press the point by returning, once again, to the partially performed voidable contract. Surely it would be fair for the claimant to rescind the contract, and cancel their future liabilities to transfer more property,<sup>69</sup> even if they are not able to recover the property so far transferred because the defendant has in the interim transferred it to a third party. The

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<sup>64</sup> W Swadling, 'Rescission, Property, and the Common Law' (2005) 121 *LQR* 123.

<sup>65</sup> B Häcker, 'Rescission of Contract and Revesting of Title: A Reply to Mr Swadling' [2006] *RLR* 106.

<sup>66</sup> *Oakes v Turquand* (1897) LR 2 HL 325; *Clough v London & NW Rly Co* (1871) LR 7 Exch 26 at 35.

<sup>67</sup> B Häcker, 'Rescission and Third Party Rights' [2006] *RLR* 21.

<sup>68</sup> Seemingly a possibility: *Niersmans v Pesticcio* [2004] EWCA Civ 372; [2004] NLJR 653 at [6].

<sup>69</sup> See too *Virgo*, above, n 3, p 27.

unpalatable alternative is that the claimant be tied into the remainder of an admittedly tainted contract, and throw good property after bad.

Rescission of a contract can be taken on its own, without reference to any proprietary ‘restitutionary’ consequences, because those consequences happen according to property law, automatically re-vesting title – or not, if third party rights are interposed, but either way without contract law needing to consider it.

### **Executed and Executory Contracts**

The discussion so far has been about contracts which have been partially performed. This is because these types of contract best showcase the inconsistencies of blurring the differences between rescission and restitution. As for contracts which are entirely executory, with nothing yet done on either side, the only relevant issue is rescission. There is no object for restitution. In other words, rescission is again naturally separate from restitution.

As for contracts which are entirely executed, with everything already completed, there are no future liabilities to cancel. Obtaining restitution would thus be the principal reason to revisit completed contracts. However, rescission still has an important role to play: when seeking restitution in unjust enrichment, past liabilities must be set aside to preclude a defence of ‘entitlement’,<sup>70</sup> what has also been called a ‘presence of basis bar’<sup>71</sup> or ‘qualification’<sup>72</sup> to unjust enrichment, or a ‘justifying ground’ for the defendant’s receipt,<sup>73</sup> or

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<sup>70</sup> N Tamblyn, ‘Unjust Enrichment, Leapfrogging, and a Defence of Entitlement’ [2014] *HKLJ* 551.

<sup>71</sup> G Virgo, ‘Demolishing the Pyramid – Presence of Basis and Risk-Taking in the Law of Unjust Enrichment’, in A Robertson and H W Tang, eds, *The Goals of Private Law*, Hart, 2009, pp 488-504.

<sup>72</sup> Burrows, above, n 6, pp 88-89.

<sup>73</sup> Mitchel et al, above, n 51, at [21-77]; A Tettenborn, *Law of Restitution in England and Ireland*, 3rd edn, Cavendish, London, 2001, pp 20-31.

a defence of ‘provision of consideration’,<sup>74</sup> or ‘receipt in satisfaction of a right’.<sup>75</sup> But still this does not mean that rescission and restitution are rolled together after all, for two reasons.

First, the defence of entitlement is not simply about contractual entitlement. The payee may be entitled to retain his receipt for other reasons: for example, it may have been paid under a court judgment (which has not otherwise been set aside or appealed).<sup>76</sup> It is a defence of entitlement broadly conceived; contractual entitlement is only one possible line of inquiry thereunder. Put another way, unjust enrichment asks whether the payee is entitled to his receipt, and another area of law, only one of which might be contract law, may provide the answer. The defence of entitlement does not inevitably and inseparably bind together restitution in unjust enrichment and rescission in contract law.

Second, the received view, against which I have argued, is that an inability to obtain restitution bars rescission, meaning that a claimant who cannot obtain restitution is for that reason also locked into an admittedly unfair contract. In short, no restitution means no rescission. In contrast, the defence of entitlement means that an inability to obtain rescission precludes restitution. In short, no rescission means no restitution – the analysis is reversed, and rightly so: if contract law says that the contract is affirmed, or is otherwise valid, and not vitiated after all, then it is not unjust for the payee to keep any money earned under it, and the payor cannot recover it back. In other words, making rescission dependent on restitution can produce unfair results, whereas the opposite, making restitution dependent on rescission, ensures a fair and self-consistent outcome.

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<sup>74</sup> S Erbacher, *Australian Restitution Law*, 2nd edn, Cavendish, Sydney, 2001, p 646.

<sup>75</sup> J Edelman and E Bant, *Unjust Enrichment in Australia*, Oxford University Press, Melbourne, 2006, p 344.

<sup>76</sup> *Marriot v Hampton* (1797) 7 TR 269; 101 ER 969; *Minshall v Revenue and Customs Commissioners* [2015] EWCA Civ 741; [2015] All ER (D) 194 (Jul).

## Summary

Rescission and restitution should be taken separately. Rescission, ie setting aside a voidable contract, is naturally a matter for contract law, as a corollary of the inquiry whether a contract is enforceable. Once the contract is set aside, contract law is spent, and can do no more. Thereafter, if a claimant is to recover anything transferred under the contract, that is a matter for unjust enrichment, or a function of property law. This explanation is attractive because it is straightforward.

It is also tidier in marking more clearly the distinction between contract law and unjust enrichment as an independent cause of action. It removes any anomaly arising from the fact that rescission in contract law is a matter of election, whereas restitution in unjust enrichment requires a court order. It also reveals a clearer approach to the notion of partial rescission.

Separating rescission and restitution also renders the vitiating factors of contract law more coherent, since those which rescind a contract would then operate similarly to mistake and frustration: contract law decides whether the contract is rescinded or void or terminated, and the principles of unjust enrichment or property law then determine whether anything transferred thereunder can be recovered.

Separation also produces results which are fairer. The so-called bars to rescission, inability to give counter-restitution, and lapse of time (what is left of lapse of time once account has been taken of the doctrine of affirmation), are better addressed in a claim in unjust enrichment – where, in both cases, they receive more skilful treatment, with counter-restitution encountering the concept of subjective devaluation, and lapse of time more appropriately formulated as a defence of change of position.



And if those defences do apply, they simply preclude the claimant from obtaining restitution in unjust enrichment. The contract would remain rescinded as a matter of contract law. If the claimant does not recover any money, nevertheless they are freed from a contract which was procured by the defendant's misbehaviour. Whereas if rescission and restitution are bundled together in contract law, without the advanced techniques of unjust enrichment, a deserving claimant might find themselves, not only without restitution, but thereby also bound to the remainder of an admittedly unfair contract.

So too where the purported bar to rescission is the interposition of third party rights. Without more, when a contract is rescinded, title to any property transferred thereunder will re-vest in the transferor. This cannot happen when a third party has, in the meantime, obtained good title to the property. But just because a claimant cannot recover property from a third party, it does not follow that they should be precluded from rescinding their contract with the defendant. Rather, rescission should be available, to clear the way to pursuing claims against the defendant. Otherwise, the claimant is doubly damned, losing their property, and continuing to be bound into an admittedly unfair contract. Instead, rescission in contract law can be taken on its own, without regard to subsequent proprietary consequences, which will occur anyway, separately, through property law.